THE CALIFORNIA PUBLIC EMPLOYEES'
RETIREMENT SYSTEM

CORPORATE GOVERNANCE CORE PRINCIPLES & GUIDELINES

Updated August 11~~March 13~~, 2006

The United States

"Everywhere shareholders are re-examining their relationships with company bosses – what is known as their system of 'corporate governance.' Every country has its own, distinct brand of corporate governance, reflecting its legal, regulatory and tax regimes… The problem of how to make bosses accountable has been around ever since the public limited company was invented in the 19th century, for the first time separating the owners of firms from the managers who run them…."

"Corporate Governance: Watching the Boss," THE ECONOMIST 3 (Jan. 29, 1994).

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I. INTRODUCTION

CalPERS' Corporate Governance[1] Program is a product of the evolution that only experience and maturity can bring. In its infancy in 1984-87, corporate governance at CalPERS was solely reactionary: reacting to the anti-takeover actions of corporate managers that struck a dissonant chord with one's sense – as **owners**[2] of the corporate entity – of accountability and fair play. The late 1980s and early 1990s represented a period in which CalPERS learned a great deal about the "rules of the game" – how to influence corporate managers, what issues were likely to elicit fellow shareowner support, and where the traditional modes of shareowner/corporation communication were at odds with current reality.

Beginning in 1993, CalPERS turned its focus toward companies considered, by virtually every measure, to be "poor" financial performers. By centering its attention and resources in this way, CalPERS could demonstrate to those who questioned the value of corporate governance very specific and tangible economic results.[3]

What have we learned during these past dozen years? We have learned that (a) company managers want to perform well, in both an absolute sense and as compared to their peers; (b) company managers want to adopt long-term strategies and visions, but often do not feel that their shareowners are patient enough; and (c) all companies – whether governed under a structure of full accountability or not – will inevitably experience both ascents and descents along the path of profitability.

We have also learned, and firmly embrace the belief that good corporate governance – that is, accountable governance – means the difference between wallowing for long (and perhaps fatal) periods in the depths of the performance cycle, and responding quickly to correct the corporate course.

As one commentator noted:

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[1] "Corporate Governance," at CalPERS, means the "relationship among various participants in determining the direction and performance of corporations. The primary participants are (1) shareowners, (2) management (led by the chief executive officer), and (3) the board of directors." (Robert A.G. Monks and Nell Minow, CORPORATE GOVERNANCE 1 (1995).)

[2] Throughout this document, CalPERS has chosen to adopt the term "shareowner" rather than "shareholder." This is to reflect our view that equity ownership carries with it active responsibilities and is not merely passively "holding" shares.

[3] See Steven L. Nesbitt, "Long-Term Rewards from Shareholder Activism: A Study of the 'CalPERS Effect'," J. OF APP. CORP. FIN. 75 (Winter 1994) [concluding that CalPERS' program generates approximately $150 million, per year, in added returns].

"Darwin learned that in a competitive environment an organism's chance of survival and reproduction is not simply a matter of chance. If one organism has even a tiny edge over the others, the advantage becomes amplified over time. In 'The Origin of the Species,' Darwin noted, `A grain in the balance will determine which individual shall live and which shall die.' I suggest that an independent, attentive board is the grain in the balance that leads to a corporate advantage. A performing board is most likely to respond effectively to a world where the pace of change is accelerating. An inert board is more likely to produce leadership that circles the wagons."

Ira M. Millstein, New York Times, April 6, 1997, Money & Business Section, p. 10.

Now, with the benefit of its experience, CalPERS is embarking on its next evolutionary step. With the Corporate Governance Core Principles and Guidelines that follow, CalPERS speaks not only to today's underperformers, but also to tomorrow's.

II. PURPOSE

The document that follows is separated into two components: **Core Principles** and **Governance Guidelines**. CalPERS believes the criteria contained in both the Principles and the Guidelines are important considerations for all companies within the U.S. market.

However, CalPERS does not expect nor seek that each company will adopt or embrace every aspect of either the Principles or Guidelines. CalPERS recognizes that some of these may not be appropriate for every company, due to differing developmental stages, ownership structure, competitive environment, or a myriad of other distinctions. CalPERS also recognizes that other approaches may equally – or perhaps even better – achieve the desired goal of a fully accountable governance structure.

CalPERS has adopted these Principles and Guidelines to advance the corporate governance dialogue by presenting the views of one shareowner, but not to attempt to permanently enshrine those views. As one shareowner, CalPERS believes that the Core Principles represent the foundation for accountability between a corporation's management and its owners. The Guidelines represent, in CalPERS' view, additional features that may further advance this relationship of accountability.

III. CORE PRINCIPLES

A. Board Independence & Leadership

Independence is the cornerstone of accountability. It is now widely recognized throughout the U.S. that independent boards are essential to a sound governance structure.[4] Therefore, CalPERS suggests:

1. **A substantial majority of the board consists of directors who are independent.**
2. **Independent directors meet periodically (at least once a year) alone, without the CEO or other non-independent directors.**

But the independence of a majority of the board is not enough. The **leadership** of the board must embrace independence, and it must ultimately change the way in which directors interact with management.

> *"In the past, the CEO was clearly more powerful than the board. In the future, both will share influence. In a sense, directors and the CEO will act as peers. Significant change must occur in the future if boards are to be effective monitors and stimulators of strategic change. Directors and their CEOs must develop a new kind of relationship, which is more complex than has existed in the past. . . ."*

Jay W. Lorsch, "The Board as A Change Agent," THE CORPORATE BOARD 1 (July/Aug, 1996).

To instill independent leadership, CalPERS suggests:

3. **When the chair of the board also serves as the company's chief executive officer, the board designates – formally or informally – an independent director who acts in a lead capacity [5] to coordinate the other independent directors.**

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[4] The National Association of Corporate Directors' (NACD's) Blue Ribbon Commission on Director Professionalism released its report in November 1996. (Hereafter "NACD Report".) The NACD Report calls for a "substantial majority" of a board's directors to be independent. This report also suggests that independence "may be compromised by" reciprocal directorships ("director interlocks"); existing significant consulting or employment relationships between the director and the company; existing substantial commercial relationships between the director's organization and the board's company; and new business relationships that develop through board membership. (NACD Report, p.9-10) The Business Roundtable's Statement on Corporate Governance (September 1997, hereafter "BRT Statement") is in general accord that a "substantial majority" of directors should be "outside (non-management)." (BRT Statement, p.10) The BRT, however, believes that financial relationships between directors and the company should be evaluated on a case-by-case basis "rather than through the application of rigid criteria." (BRT Statement, p.11)

[5] The potential duties of a "lead independent director" are illustrated in Appendix A. See also NACD Report, at p. 4 ["Boards should consider formally designating a non-executive chairman or other independent board leader. If they do not make such a designation, they should designate, regardless of title, independent members to lead the board in its most critical functions . . . ."]."The BRT also believes that it is desirable for

4. Certain board committees consist entirely of independent directors. These include the committees who perform the following functions:

Audit
Director Nomination
Board Evaluation & Governance
CEO Evaluation & Management Compensation[6]
Compliance & Ethics[7]

Lastly, independence also requires a lack of conflict between the director's personal, financial, or professional interests, and the interests of shareowners.

> *"A director's greatest virtue is the independence which allows him or her to challenge management decisions and evaluate corporate performance from a completely free and objective perspective. A director should not be beholden to management in any way. If an outside director performs paid consulting work, he becomes a player in the management decisions which he oversees as a representative of the shareholder…."*

Robert H. Rock, Chairman NACD, DIRECTORS & BOARDS 5 (Summer 1996).

Accordingly, CalPERS recommends that:

5. No director may also serve as a consultant or service provider to the company.[8]

6. Director compensation is a combination of cash and stock in the company. The stock component is a significant portion of the total compensation.[9]

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directors to have an understanding as to how non-executive leadership of the board would be provided, whether on an ongoing basis or on a rotational basis if and whether the need arose." (BRT Statement, p.13) A recommended definition of "independent director" is provided in Appendix B.

[6] See NACD Report, p. 5.

[7] See Harvey L. Pitt, Karl A. Groskaufmanis, and Vasiliki B. Tsaganos, "Talking the Talk and Walking the Walk: Director Duties to Uncover and Respond to Management Misconduct," CLIENT LETTER FROM FRIED, FRANK, HARRIS, SHRIVER & JACOBSON, Feb. 21, 1997, p. 5.

[8] "A firm's board of directors owes its fiduciary responsibilities to the common stockholders of the firm. If the directors also serve as consultants to the firm's management, then their willingness to confront management when they think they have done something wrong is limited -- for to confront management is to risk the loss of those management consulting fees. Even if directors are not swayed by the prospect of losing their consulting fees, academic studies indicate that investors appear to view the prospect that they might as sufficient reason to discount the firm's shares." (John D. Martin and Robert Parrino, "Using Directors as Consultants," DIRECTORS & BOARDS 32, 35 (Summer 1996).)

B. Board Processes & Evaluation

No board can truly perform its overriding functions of establishing a company's strategic direction and then monitoring management's success without a system of evaluating itself. CalPERS views this self-evaluation to have several elements, including:

1. **The board has adopted a written statement of its own governance principles[10], and regularly re-evaluates them.**

2. **With each director nomination recommendation, the board considers the mix of director characteristics, experiences, diverse perspectives and skills that is most appropriate for the company. Additionally, the board should address historically under-represented groups on the board, including woman and minorities.[11]**

3. **The board establishes performance criteria for itself, and periodically reviews board performance against those criteria.[12]**

4. **The independent directors establish performance criteria and compensation incentives for the CEO, and regularly reviews the CEO's performance against those criteria.[13] The independent directors have access to advisers on this subject, who are independent of management. Minimally, the criteria ensure that the CEO's interests are aligned with the long-term interests of shareowners, that the CEO is evaluated against comparable peer groups, and that a significant portion of the CEO's total compensation is at risk.**

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[9] See NACD Report at p. 5, referring to 1995 Report of the NACD Blue Ribbon Commission on Director Compensation. See also GM BOARD OF DIRECTORS CORPORATE GOVERNANCE GUIDELINES ON SIGNIFICANT CORPORATE GOVERNANCE ISSUES (Adopted January 1994; Revised August 1995; hereafter "GM Guidelines"); Guideline No. 13.

[10] General Motors is perhaps the most well known company to have formally adopted governance principles. However, as of May 1995, nearly 70% of the largest 300 U.S. companies had also adopted written governance principles.

[11] CalPERS does not believe that each director must possess all of the core competencies. Rather, following the conclusion of the NACD Report, we believe that *each* director should contribute some knowledge, experience or skill in at least *one* domain that is critical to the company. (See NACD Report, at p. 8-9.) In addition, CalPERS believes that consideration of the appropriate director skill mix should also include consideration of obtaining a diversity of experiences and perspectives within the board. (See BRT Statement, at p. 7.)

[12] See NACD Report, at p. 16-17. See also BRT Statement, at p. 9.

[13] See BRT Statement, at p. 5.

C. Executive Compensation

Compensation programs are one of the most powerful tools available to the company attract, retain, and motivate key employees, as well as align their interests with the long-term interests of shareowners. Poorly designed compensation packages can have disastrous impacts on the company and its shareowners by incentivising short-term oriented behavior.

1. **Executive compensation programs should be designed and implemented to ensure alignment of interest with the long-term interests of shareowners.**

2. **Executive compensation should be comprised of a combination of cash and equity based compensation, and direct equity ownership should be encouraged.**

3. **Executive compensation policies should be transparent to shareowners. The policies should contain, at a minimum, compensation philosophy, the targeted mix of base compensation and "at risk" compensation, key methodologies for alignment of interest, and parameters for guidance of employment contract provisions, including severance packages. Appendix D sets forth the specific areas that executive compensation policies should address.**

4. **Companies should submit executive compensation polices to shareowners for approval.**

5. **Executive contracts should be fully disclosed, with adequate information to judge the "drivers" of incentive components of compensation packages.**

D. Individual Director Characteristics

In CalPERS' view, each director should add something unique and valuable to the board as a whole. Each director should fit within the skill sets identified by the board. No director, however, can fulfill his or her potential as an effective board member without a personal dedication of time and energy and an ability to bring new and different perspectives to the board.

1. The board has adopted guidelines that address the competing time commitments that are faced when director candidates serve on multiple boards. These guidelines are published annually in the company's proxy statement. [14]

E. <u>Audit Integrity</u>

The company should support the development of accurate audited financial statements. CalPERS believes annual audits of financial statements should be required for all companies and carried out by an independent external auditor. This audit should provide and objective opinion that the financial statements present fairly, in all material respects, the financial position of the company in conformity with applicable laws, regulations and standards.

1. The selection of the independent external auditor should be ratified by shareowners annually.

IV. GOVERNANCE GUIDELINES

Section III (above), containing the Core Principles, represents CalPERS' view of the elements of corporate governance that form the foundation of accountability between a company's managers and its owners. During its decade-long experience in examining governance structures, CalPERS has found that there are many additional features that are important considerations in the continuing evolution of "corporate governance." The importance of these issues often varies from company to company, depending upon the unique composition of each board and the special challenges that each company faces. CalPERS offers the following Governance Guidelines as additional topics for discussion in the governance dialogue.

A. <u>Board Independence & Leadership</u>

[14] See NACD Report, at p. 10-12 [recommending that candidates who are CEOs or senior executives of public corporations be "preferred" if they hold no more than 1-2 public company directorships; other candidates who hold full-time positions be preferred if they hold no more than 3-4 public company directorships; and all other candidates be preferred if they hold no more than 5-6 other public company directorships.] See also BRT Statement, at p. 8. However, surveys indicate that directors spend an average of 190 hours per year preparing for and attending each organization's board and committee meetings. (Jeremy Bacon, CORPORATE BOARDS AND CORPORATE GOVERNANCE, 22-24 (New York, The Conference Board, 1993.) With this level of time commitment, CalPERS believes that limitations greater than recommended by the NACD may be appropriate. "The job of being the CEO of a major corporation is one of the most challenging in the world today. Only extraordinary people are capable of performing it adequately; a small portion of these will appropriately be able to commit some energy to directorship of one other enterprise. No CEO has time for more than that." (Robert A.G. Monks, "Shareholders and Director Section", DIRECTORS & BOARDS (Spring 1995), as quoted in Autumn 1996 volume, p.158)

1. Directors, managers and shareowners should come together to agree upon a uniform definition of "independence." Until this uniformity is achieved, each company should publish in its proxy statement the definition adopted or relied upon by its board.

2. With each director nomination recommendation, the board should consider the issue of continuing director tenure and take steps as may be appropriate to ensure that the board maintains openness to new ideas and a willingness to critically re-examine the status quo.

Nearly all corporate governance commentators agree that boards should be comprised of at least a majority of "independent directors" (with a growing trend toward a "substantial majority, see III.A.1 above). There is, however, no current agreement as to what constitutes "independence." Despite these varying opinions, CalPERS believes an opportunity now exists for those involved in this debate to come together to craft a definition that generally meets the needs of all. Toward this end, CalPERS offers the definition of independent director set forth in Appendix B.

3. When selecting a new chief executive officer, boards should re-examine the traditional combination of the "chief executive" and "chairman" positions.

There has been much debate concerning the wisdom, and feasibility, of an "independent chair" structure in American corporate culture. Although this structure is more common in European corporations[15], it remains the exception in the United States. CalPERS believes that true board independence may ultimately – within the next decade – require a serious re-examination of this historic combination of powers.[16]

CalPERS also believes that much of the current debate in the U.S. is the result of uncertainty and a lack of a clear definition of the role of an independent chair. Many

[15] In a recent study of the impact within the United Kingdom market of separating, or combining, the roles of CEO and chair, the author found a "significant positive market reaction . . . followed the separation of the responsibilities of chairman and CEO." Also, companies that announced a separation subsequently performed better than their counterparts based on several accounting measures. Conversely, companies that announced combination of the positions resulted in "the largest negative market response the day after the announcement." (J. Dahya et al., "The Case for Separating the Roles of Chairman and CEO: An Analysis of Stock Market and Accounting Data," 4 CORP. GOVERNANCE 71, 76 (1996).)

[16] "The function of the chairman is to run board meetings and oversee the process of hiring, firing, evaluating, and compensating the CEO . . . . Without the direction of an independent leader, it is much more difficult for the board to perform its critical function." (Michael C. Jensen, "Presidential Address: The Modern Revolution, Exit and the Failure of Internal Control Systems," 48 J. OF FIN. 831, 866 (1993).) "Wearing both hats is like grading your own paper." (Anne Hansen, deputy director of the Council of Institutional Investors, as quoted in "A Walk on the Corporate Side," TRUSTEE 9, 10 (Nov/Dec. 1996).) See also, Constance E. Bagley and Richard H. Koppes, "Leader of the Pack: A Proposal for Disclosure of Board Leadership Structure," 34 SAN DIEGO L. REV. 149, 157-158.

commentators are concerned that the separation of the roles of the CEO and Chairperson of the board would undermine the CEO, confuse accountability, and disrupt daily company operations. CalPERS agrees that an independent chair should not effectively equate to a "co-CEO" role; rather, CalPERS sees the role – although vital – as quite narrow. To promote further dialogue of this issue, CalPERS offers in Appendix C a possible "Independent Chair Position Duty Statement."

B. Board Processes & Evaluation

In addition to the processes described in the Core Principles, above, CalPERS recommends that boards consider the following:

1. **The board should have in place an effective CEO succession plan, and receive periodic reports from management on the development of other members of senior management.**

2. **All directors should have access to senior management. However, the CEO, chair, or independent lead director may be designated as liaison between management and directors to ensure that the role between board oversight and management operations is respected.**[17]

3. **The board should periodically review its own size, and determine the size that is most effective toward future operations.**[18]

C. Individual Director Characteristics

Many of the Corporate Governance Core Principles and Guidelines in this document would not be necessary if corporate boards had an effective means of evaluating individual director performance. It is this seeming inability to promptly replace directors who are not fully contributing toward overall board success that has led shareowners to question many concepts that would, under a true delegation of management responsibility to boards, otherwise be unnecessary.

With this in mind, CalPERS recommends that:

1. **Each board should establish performance criteria, not only for itself (acting as a collective body) but also individual behavioral expectations**

[17] See GM Guidelines, No. 12. See also BRT Statement, at p. 18.

[18] See NACD Report, at p. 4, 5.

for its directors. Minimally, these criteria should address the level of director attendance, preparedness, participation, and candor.[19]

2. **To be re-nominated, directors must satisfactorily perform based on the established criteria. Re-nomination on any other basis should neither be expected nor guaranteed.**

3. **Generally, a company's retiring CEO should not continue to serve as a director on the board.**[20]

4. **The board should establish and make available to shareowners the skill sets the board seeks from director candidates. Minimally, these core competencies should address accounting or finance, international markets, business or management experience, industry knowledge, customer-base experience or perspective, crisis response, or leadership or strategic planning.**

D. Corporate Responsibility

Companies are expected to conduct themselves with propriety and with a view toward responsible corporate conduct. A level of performance above minimum adherence to the law is generally expected.

CalPERS believes that it is the responsibility of companies to provide meaningful, consistent, and robust reporting of environmental practices, risks and potential liabilities. With adequate, accurate and timely data disclosure, shareowners are able to more effectively make investment decisions by taking into account the environmental practices of the companies in which the Fund invests.

1. **To ensure sustainable long-term returns, companies should provide accurate and timely disclosure of environmental risks, such as those associated with climate change.**

E. Shareowner Rights

Shareowner rights – or those structural devices that define the formal relationship between shareowners and the directors to whom they delegate corporate control – are not typically featured in the governance principles adopted by corporate boards. CalPERS generally believes that, if the Principles and Guidelines described above

[19] See NACD Report, at p. 16-17.

[20] "What about losing the accumulated experience of the retiring CEO? That is easily solved. If the new CEO wants to tap the perceived wisdom and experience of the retired CEO, a telephone call or a quiet meeting does not require a board seat." (Former Citicorp Chairman Walter Wriston, "Resist the Desire to Stay On," DIRECTORS & BOARDS (Spring 1993) 35.)

are internalized and become part of the way in which American corporations operate, then shareowners should trust that independent boards will make the decisions that promote long-term shareowner interests – whether those decisions concern shareowner rights or other issues. But, we are not yet at that point. Therefore, to help build tomorrow's corporate governance structure, CalPERS offers today's corporate boards the following views on issues affecting shareowner rights:

1. A majority of proxies cast should be able to amend the company's bylaws by shareowner proposal.

2. A majority of shareowners should be able to call special meetings.

3. A majority of shareowners should be able to act by written consent.

4. Every company should prohibit greenmail.

5. No board should enact nor amend a poison pill except with shareowner approval.

6. Every director should be elected annually.

7. Proxies should be kept confidential from the company, except at the express request of shareowners.

8. Broker non-votes should be counted for quorum purposes only.

9. A shareowner proposal that is approved by a majority of proxies cast should be implemented by the board.

10. Shareowners should have effective access to the director nomination process.

11. All equity based compensation plans should be shareowner approved. All material changes to existing equity based compensation plans, including repricings of any form, should be shareowner approved.

12. In an uncontested director election, a majority of proxies cast should be required to elect a director. In a contested election, a plurality of proxies cast should be required to elect a director.

13. A majority of shareowners should be able to remove a director with or without cause.

V. CONCLUSION

In adopting these Core Principles and Governance Guidelines, CalPERS' goal is to stimulate healthy debate. To the extent this document evokes disagreements, may these disagreements be used to promote greater clarity of thought. With continued experience and communication between corporate managers and owners, the issue of accountability can become – if not resolved – more clear.

> *"As conflict – difference – is here in the world, as we cannot avoid it, we should, I think, use it. Instead of condemning it, we should set it to work for us… So in business, we have to know when to … try to capitalize [on conflict], when to see what we can make it do…. [In that light] it is possible to conceive of conflict as not necessarily a wasteful outbreak of incompatibilities but a normal process by which socially valuable differences register themselves for the enrichment of all concerned…. Conflict at the moment of the appearing and focusing of difference may be a sign of health, a prophecy of progress."*

THE PRICE WATERHOUSE CHANGE INTEGRATION TEAM, THE PARADOX PRINCIPLES 275 (quoting Mary Parker Follett) (1996).

APPENDIX A

LEAD INDEPENDENT DIRECTOR POSITION DUTY STATEMENT

The chief executive officer is the senior executive of the Company. The CEO is responsible for:

- Providing management of the day-to-day operations of the Company;
- Recommending policy and strategic direction of the Company, for ultimate approval by the Board of Directors; and
- Acting as the spokesperson of the Company.

In contrast, the Lead Independent Director is responsible for coordinating the activities of the independent directors. In addition to the duties of all Board members as set forth in the Company's Governance Guidelines, the specific responsibilities of the Lead Independent Director are as follows:

- Advise the Chair as to an appropriate schedule of Board meetings, seeking to ensure that the independent directors can perform their duties responsibly while not interfering with the flow of Company operations.
- Provide the Chair with input as to the preparation of the agendas for the Board and Committee meetings.
- Advise the Chair as to the quality, quantity and timeliness of the flow of information from Company management that is necessary for the independent directors to effectively and responsibly perform their duties; although Company management is responsible for the preparation of materials for the Board, the Lead Independent Director may specifically request the inclusion of certain material.
- Recommend to the Chair the retention of consultants who report directly to the Board.
- Interview, along with the chair of the [nominating committee], all Board candidates, and make recommendations to the [nominating committee] and the Board.

- Assist the Board and Company officers in assuring compliance with and implementation of the Company's [Governance Guidelines]; principally responsible for recommending revisions to the [Governance Guidelines].
- Coordinate, develop the agenda for and moderate executive sessions of the Board's independent directors; act as principal liaison between the independent directors and the Chair on sensitive issues.
- Evaluate, along with the members of the [compensation committee/full board], the CEO's performance; meet with the CEO to discuss the Board's evaluation.
- Recommend to the Chair the membership of the various Board Committees, as well as selection of the Committee chairs.

DEFINITION OF
INDEPENDENT DIRECTOR

"Independent director" means a director who:

- Has not been employed by the Company in an executive capacity within the last five years.
- Is not, and is not affiliated with a company that is, an adviser or consultant to the Company or a member of the Company's senior management.
- Is not affiliated with a significant customer or supplier of the Company.
- Has no personal services contract(s) with the Company, or a member of the Company's senior management.
- Is not affiliated with a not-for-profit entity that receives significant contributions from the Company.
- Within the last five years, has not had any business relationship with the Company (other than service as a director) for which the Company has been required to make disclosure under Regulation S-K of the Securities and Exchange Commission.
- Is not employed by a public company at which an executive officer of the Company serves as a director.
- Has not had any of the relationships described above with any affiliate of the Company.
- Is not a member of the immediate family of any person described above.

APPENDIX C

INDEPENDENT CHAIR
POSITION DUTY STATEMENT

The chief executive officer is the senior executive of the Company. The CEO is responsible for:

- Providing management of the day-to-day operations of the Company;
- Recommending policy and strategic direction of the Company, for ultimate approval by the Board of Directors; and
- Acting as the spokesperson of the Company.

In contrast, The Independent Chair is responsible for coordinating the activities of the Board of Directors. In addition to the duties of all Board members as set forth in the Company's [Governance Guidelines], the specific responsibilities of the Independent Chair are as follows:

- Conduct all meetings of the Board and the meetings of shareowners.
  Serve as an ex-officio member of each of the committees of the Board of which the Independent Chair is not a member.
- Schedule Board meetings in a manner that enables the Board and its Committees to perform their duties responsibly while not interfering with the flow of Company operations.
- Prepare, in consultation with the CEO and other directors and Committee chairs, the agendas for the Board and Committee meetings.
- Define the quality, quantity and timeliness of the flow of information between Company management and the Board; although Company management is responsible for the preparation of materials for the Board, the Independent Chair may specifically request the inclusion of certain material.
- Approve, in consultation with other directors, the retention of consultants who report directly to the Board.
- Interview, along with the chair of the nominating committee, all Board candidates, and make recommendations to the nominating committee and the Board.
- Assist the Board and Company officers in assuring compliance with and implementation of the Company's Governance Guidelines; principally responsible for recommending revisions to the Governance Guidelines.
- Develop the agenda for and moderate executive sessions of the Board's independent directors; act as principal liaison between the independent directors and the CEO on sensitive issues.
- Evaluate, along with the members of the compensation committee/full board, the CEO's performance; meet with the CEO to discuss the Board's evaluation.
- Recommend to the full Board the membership of the various Board committees, as well as selection of the committee chairs.

Executive Compensation Policies

The annual compensation committee report provides for an acceptable mechanism by which executive compensation policy provisions can be addressed to ensure the proper alignment of executive compensation practices with shareowner interests.

At a minimum, provisions should address:

A.) Structure and components of total compensation.

B.) Incentive and bonus compensation.

1. Specific performance objectives should be set before the start of a compensation period while the previous years' objectives which triggered incentive payouts should be disclosed.
2. Provisions for the resetting of performance hurdles in the event that incentive grants are retested[21] should be disclosed.
3. Companies should develop and disclose a policy for recapturing bonus and incentive payments that were made to executives on the basis of having met or exceeded performance targets during a period of fraudulent activity or a material negative restatement of financial results for which executives are found personally responsible.
4. A process should be disclosed by which additional compensation for executives, which coincides with the sale or purchase of substantial company assets, can be ratified by shareowners.

C.) Equity compensation.

1. In the event of a merger, acquisition, or change in control, unvested equity should not accelerate but should instead convert into the equity of the newly formed company.
2. Distribution of dividend equivalent dividends on unvested equity should be prohibited unless a provision exists that would recoup payouts made on unvested equity.
3. Equity grants should vest over a period of at least three years.
4. Expected equity grant issue dates should be pre-established, set, and disclosed by the compensation committee. Realized grant dates should be publicly disclosed at the latest on the day following the date of grant. The rationale for any amendment to pre-established grant dates should be disclosed with justification describing how the amendment benefits shareowners.

[21] "Retested" means extending a performance period to enable initial targets to be achieved.

D.) Utilizing and disclosing performance criteria.

1. The use of time vested equity, which supercedes any other performance metric, as the sole component to construct performance-based compensation plans, is not an appropriate pay-for-performance model.

E.) Use and disclosure of severance agreements.

1. Severance agreements[22] that provide benefits[23] with a total present value exceeding market standards[24] should be ratified by shareowners.

F.) Use of "other" forms of compensation.

G.) Use of retirement plans.

1. Defined contribution and defined benefit retirement plans should be clearly disclosed in tabular format showing all benefits available whether from qualified or non-qualified plans and net of any offsets.

[22] Severance agreement means any agreement that dictates what an executive will be compensated when the company terminates employment without cause or when there is a termination of employment following a finally approved and implemented change in control.
[23] Severance benefits mean the value of all cash and non-cash benefits, including, but not limited to, the following: (i) cash benefits; (ii) perquisites; (iii) consulting fees; (iv) equity and the accelerated vesting of equity, (v) the value of "gross-up" payments; and (vi) the value of additional service credit or other special additional benefits under the company's retirement system. Severance benefits do not include already accrued pension benefits.
[24] The disclosed threshold in the United States should not exceed 2.99 times the sum of the executive's base salary plus target bonus which is consistent with IRS standards as of January 1, 2006.